

Expansion on track

China Retail

Prime Success (210 HK, HK\$4.37)

HOLD (unchanged)

Target price: HK\$5.0 (+14%)

Prime Success (PS) brand business is on track for its store expansion plan. Loss from “Shoebox” is expected to narrow in 1H FY12/06 and achieve a breakeven by the end of 2006. Overall operating margin is on an uptrend, thanks to 1) a higher ASP and 2) the end of shop remodeling and renovation. We expect the OEM business will deliver upside surprises with additional higher-margin brands.

Store expansions are still on track to meet the previous target of 5,000 POS by 2010 from 1,609 POS in FY12/05A, with 400 POS net adds each year. In 1H FY12/06, PS has already added c. 200 POS. Total number of self-operated stores under Daphne reached c.1,200 in 1H06. Both Shoebox and Adidas Original have achieved c. 100 POS respectively in 1H06. Shoebox is on track to add 70 POS in FY12/06.

Shoebox targets to achieve a breakeven in FY12/06. Shoebox was first launched in May 2004, with an initial investment of HK\$100m, of which HK\$50m came from its partners. Loss from Shoebox narrowed to HK\$2.8m in FY12/05A from HK\$3.7m in 1H FY12/05A. It is expect to achieve a breakeven by the end of 2006 when its stores achieve a certain economies of scale.

Potential upside surprises from the OEM business. Apart from customers like Payless, Walmart and Target, PS continues to add other higher-margin customers, such as Unisa, Aerosoles, Gap and Umbro. PS expects OEM sales to achieve at least a high single-digit growth in FY12/06F. However, the OEM business will not be its focus going forward. The Company expects contribution from OEM business to total sales will fall from 30% in FY12/05A to 15%-20% in the future, with robust growth from its brand business.

Margins are on an uptrend. PS targets to raise its ASP by 2% to 3% every year, FY12/06 is no exception. Apart from improvement in ASP, costs also declined. PS began its shop remodeling exercise since 2005, such exercise is carried out every five to seven years. The renovation has dragged down its operating margin slightly in FY12/05A as a result. PS has already renovated >500 POS in 2005, with only 400 POS remaining, which is scheduled to be finished by 2007. As a result, margins are trending up in 2006. Apart from the above, PS adopts an accounting policy of expensing its store renovation and investment costs instead of capitalizing them. This is the main result behind its relatively low operating margin of c.12.3%. If they change the accounting policy, operating margin will increase by at least 3% to reach 15%.

Brand licensing business. Apart from the OEM and retail business, PS has licensed its brands to other operators for accessories sales such as sunglasses and bags. No sales breakdown from the brand licensing business is available, but growth is promising at the initial stage.

Rental cost is not a concern. PS is able to control rental at c.20% of total sales. It will renew around 1/5 of its

Table 1: Financial summary

Year to Dec	Net profit HK\$m	EPS HK\$	EPS Δ %	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
05A	246.8	0.152	34.5	28.7	10.2	20.0	1.1	40.0	42.2	Cash
06A	338.4	0.207	35.6	21.1	7.6	14.3	1.4	41.3	45.3	Cash
07F	449.5	0.274	32.8	15.9	5.7	10.4	1.8	40.9	46.1	Cash
08F	583.0	0.356	29.7	12.3	4.2	7.8	2.1	39.5	45.4	Cash
09F	737.9	0.450	26.6	9.7	3.2	6.1	2.3	37.3	43.2	Cash

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total leases every year with 2 to 3 years terms.

Capex plan. PS has budgeted c. HK\$200m capex for FY12/06-07. Approximately, HK\$60-80m will be used to construct two more logistic centres in Chengdu and Guangdong and HK\$60-70m will be used in expanding office space and HK\$50-80m for store expansions.

Valuations. PS trades at 21x P/E for FY12/06F. Its share price has fallen by 18% since its annual result in April. However, we believe valuation is still rich compared to the industry average of 16x FY12/06F P/E. We have revised down our target price to HK\$5.0 (prev. HK\$5.5), equivalent to 18x FY12/07F P/E. We maintain our HOLD recommendation.

Table 2: Peer comparisons

Stock	Ticker	Currency	Share Price	Market cap (US\$m)	P/E (x) FY06F	P/E (x) FY07F	Gross margin (%)	Operating margin (%)	ROA (%)	ROE (%)	Yield (%)
Branded footwear											
Prime Success	210	HKD	4.37	909.2	20.6	15.2	43.6	12.01	20.3	39.8	1.2
Mirabell	1179	HKD	2.55	83.2	8.4	7.2	58.4	6.01	11.2	15.2	3.5
Le Saunda	738	HKD	1.48	96.9	n.a.	n.a.	51.2	12.2	13.6	16.3	4.7
Hongguo	HGUO	SGD	0.715	176.8	16.5	12.6	33.0	13.15	17.0	24.7	0
China Hongxin Sports	CHHS	SGD	1.62	410.3	18.6	11.5	34.2	17.53	9.6	14.6	0
Average					16.0	11.7	44.1	12.2	14.3	22.1	1.9
OEM footwear											
Yue Yuen	551	HKD	22.15	4,558.1	13.1	11.4	23.1	8.71	10.2	16.8	0.5
Symphony	1223	HKD	1.02	217.7	7.7	6.9	22.9	11.37	13.0	18.6	6.9
Kingmaker footwear	1170	HKD	0.92	77.3	18.4	11.5	13.4	4.73	6.4	8.8	8.7
Average					13.1	9.9	19.8	8.3	9.9	14.7	5.3
Overall average					14.8	10.9	35.0	10.7	12.7	19.4	3.2

Source: SBI E2-Capital